

In this [past weekend's newsletter](#), I touched on the outcome of the mid-term elections and why it would likely not be as optimistic as the mainstream media was portraying it to be. To wit:

"It is likely little will get done as the desire to engage in conflict and positioning between parties will obliterate any chance for potential bipartisan agenda items such as infrastructure spending. So, really, despite all of the excitement over the outcome of the mid-terms, it will likely mean little going forward. The bigger issue to focus on will be the ongoing impact of rising interest rates on major drivers of debt-driven consumption such as housing and auto sales. Combine that with a late stage economic cycle colliding with a Central Bank bent on removing accommodation and you have a potentially toxic brew for a much weaker outcome than currently expected."

I also wrote:

"With portfolios reduced to 50% equity, we have a bit of breathing room currently to watch for what the market does next. It is EXTREMELY important the market rally next week above Wednesday's highs or we will likely see another decline to potentially test the recent lows."

Unfortunately, on Monday, nothing good happened. While the week is not over yet, the failure of the S&P 500 at the 50-dma now turns that previous support to important resistance. Furthermore, the failure of the market to hold the 200-dma also increases the downside risk of the market currently.

S&P 500 Index (Large Caps)

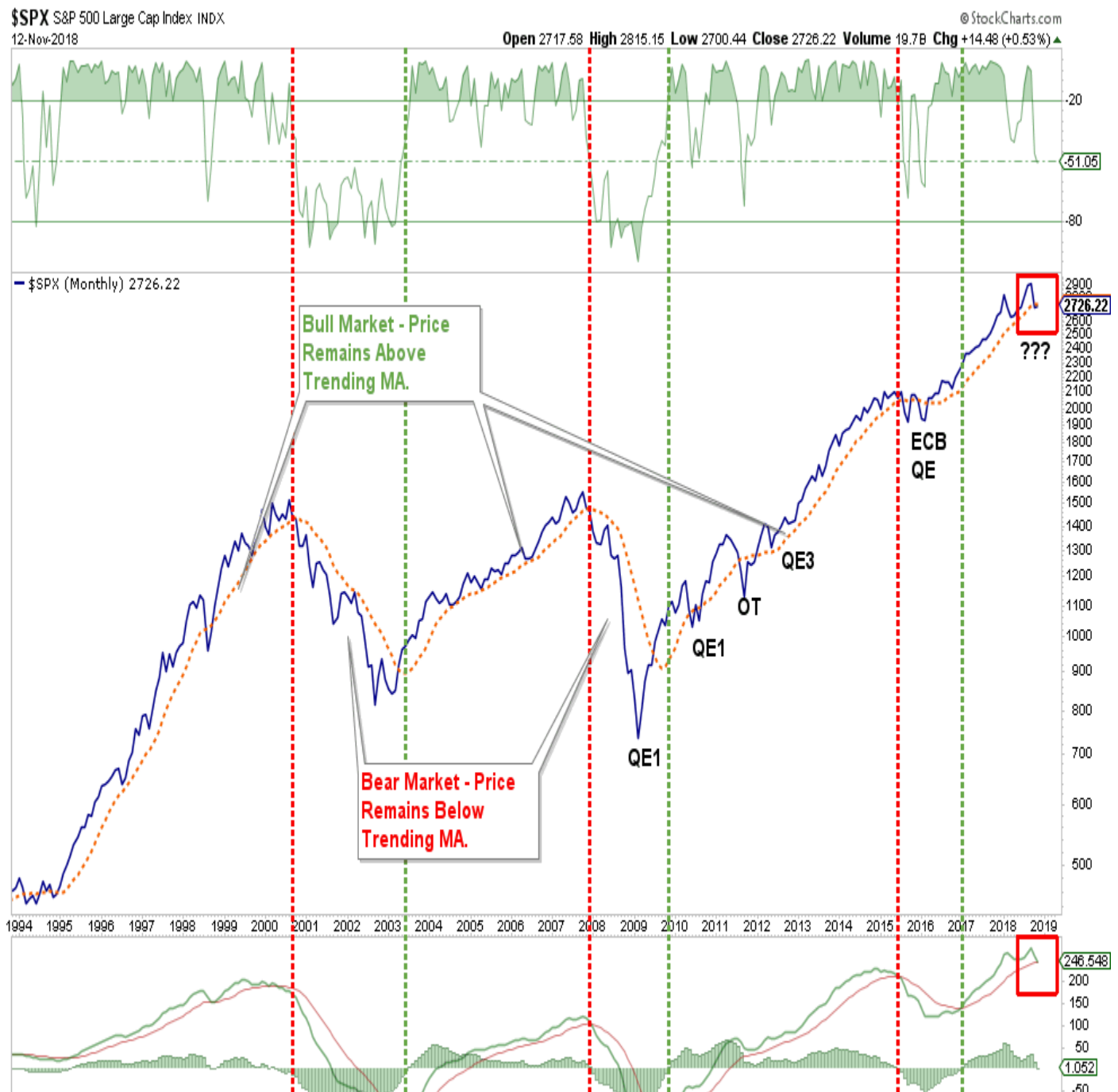
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- If prices are generally "*trending higher*" then such is considered a "*bull market*."
- A "*bear market*" is when the "*trend*" changes from positive to negative.

The vertical red and green lines denote the confirmation of the change in trend when all three indicators simultaneously align.

- The price of the market moves below the long-term moving average. ?
- The long-term overbought condition is reversed (top indicator) ?
- The long-term MACD signal changes from "buy" to "sell" X



Importantly, note that just a violation of the long-term moving average is not confirmation of a change to the ongoing bull trend. Over the last decade, there were several violations of the long-term moving average which were quickly reversed by Central Bank interventions (*QE2 and Operation Twist*). In late 2015, all indications of the start of a *"bear market"* coincided as the Federal Reserve had launched into their rate hiking campaign. However, that bear market was cut short through the injections of liquidity from the ECB's own QE program. Currently, with Central Banks globally beginning to reduce or extract liquidity from the financial markets, and the Federal Reserve committed to hiking rates, there seems to be no ready *"backstop"* for the markets currently. However, since this is a monthly chart, we will have to wait until December 1st to update these indicators. However, if the market doesn't begin to exhibit a more positive tone by then, **all three indicators of a "bear market" will align for only the 4th time in 25-years.** But it isn't just the S&P 500 exhibiting these characteristics. The S&P 400 has not only failed at a retest of the longer-term moving average but mid-caps are close to registering a *"change in the trend"* as the 50-dma crosses below the 200-dma.



(Note: we have previously closed all mid-cap positions in our portfolios) While the S&P 600 is not as close as the S&P 400 to registering a *"change in trend,"* it likely won't be long before it does. The failure of small-caps at the 200-dma is confirming additional downward pressure on those companies as concerns over ongoing *"tariffs"* and *"trade wars"* are most impactful to small and mid-sized company profitability.

S&P 600 Index (Small Caps)

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(Note: we have previously closed all small-cap positions in our portfolios) The Russell 2000 is also confirming the same. The index is extremely close to registering a "change in trend" as the 50-dma approaches a cross of the 200-dma. Also, with the index failing at the 200-dma and turning lower, just as with small and mid-cap indices above, a break of recent lows will confirm a "bear market" has started in these markets.



But what is happening domestically should not be a surprise. The rest of the world markets have already confirmed bear market trends and continue to trade below their long-term moving averages. (*The very definition of a bear market.*) While it has been believed the U.S. can "decouple" from the rest of the world, such is not likely the case. The pressure on global markets is a reflection of a slowing global economy which will ultimately find its way back to the U.S.

MSCI All-World Index (Ex-US)

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(Note: we closed all international and emerging market positions in our portfolios at the beginning of this year.) Just as a side note, China has been in a massive bear market trend since 2015 and is down nearly 50% from its previous highs.

Shanghai Composite Index

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While much of the mainstream media continues to suggest the "bull market" is alive and well, there are a tremendous [number of warning signs](#) which are suggesting that something has indeed "changed."

*"The tailwinds that existed for the market over the last couple of years from tax cuts, to natural disasters, to support from Central Banks have now all run their course. The backdrop of the market currently is vastly different than it was during the ?taper tantrum? in 2015-2016, or during the corrections following the end of QE1 and QE2. In those previous cases, the Federal Reserve was directly injecting liquidity and managing expectations of long-term accommodative support. Valuations had been through a fairly significant reversion, and expectations had been extinguished. **None of that support exists currently.**"*

The ongoing deterioration in the markets continues to confirm, [as I wrote back in April](#), the bull market that started in 2009 has ended. However, we will likely not know for certain until we get into 2019, but therein lies the biggest problem. Waiting for verification requires a greater destruction of capital than we are willing to endure.

*(Note: Just because the bull market has ended doesn't mean it will never resume again. It is simply a transition to remove excesses from the market. **Bear markets are a good thing as it creates long-term opportunities.**)*

We have already taken steps to reduce equity risk and will do more on rallies that fail to re-establish the previous bullish trends in the market. If I am right, the more conservative stance will protect capital in the short-term. The reduced volatility allows for a logical approach to further adjustments as the correction becomes more apparent. *(The goal is not to be forced into a ?panic selling? situation.)* If I am wrong, and the bull market resumes, we simply remove hedges and reallocate equity exposure.

?There is little risk, in managing risk.?

If you have taken NO actions in your portfolio as of yet, use rallies which fail at resistance to "do something." I have reprinted our portfolio management rules as a guide.

RIA Portfolio Management Rules

1. **Cut losers short.** *(Reduce the risk of fundamentally poor companies.)*
2. **Set goals and be actionable.** *(Without specific goals, trades become arbitrary and increase overall risk.)*
3. **Emotionally driven decisions void the investment process.** *(Buy high/sell low)*
4. **Follow the trend.** *(80% of portfolio performance is determined by the long-term, monthly, trend. While a ?rising tide lifts all boats,? the opposite is also true.)*
5. **Never let a ?trading opportunity? turn into a long-term investment.** *(Refer to rule #1. All initial purchases are ?trades,? until your investment thesis is proved correct.)*
6. **An investment discipline does not work if it is not followed.**
7. **?Losing money? is part of the investment process.** *(If you are not prepared to take losses when they occur, you should not be investing.)*
8. **The odds of success improve greatly when the fundamental analysis is confirmed by the technical price action.** *(This applies to both bull and bear markets)*
9. **Never, under any circumstances, add to a losing position.** *(As Paul Tudor Jones once quipped: ?Only losers add to losers.?)*

10. **Markets are either *?bullish?* or *?bearish?*. During a *?bull market?* be only long or neutral. During a *?bear market?* be only neutral or short. (Bull and Bear markets are determined by their long-term trend as shown in the chart below.)**
11. **When markets are trading at, or near, extremes do the opposite of the *?herd?***
12. **Do more of what works and less of what doesn't. (Traditional rebalancing takes money from winners and adds it to losers. Rebalance by reducing losers and adding to winners.)**
13. ***?Buy?* and *?Sell?* signals are only useful if they are implemented. (Managing a portfolio without a *?buy/sell?* discipline is designed to fail.)**
14. **Strive to be a .700 *?at bat?* player. (No strategy works 100% of the time. However, being consistent, controlling errors, and capitalizing on opportunity is what wins games.)**
15. **Manage risk and volatility. (Controlling the variables that lead to investment mistakes is what generates returns as a byproduct.)**

It should be remembered that all good things do come to an end. Sometimes, those endings can be very disastrous to long-term investing objectives. This is why focusing on *?risk controls?* in the short-term, and avoiding subsequent major draw-downs, the long-term returns tend to take care of themselves.

Everyone approaches money management differently. This is just our approach and we are simply sharing it with you. We hope you find something useful in it.